Background - History of EMS

The events of the early 1990's in Europe and the former Soviet Union have resulted in a significant easing of the U.S. and multilateral export controls on West-East trade. At the same time, developments in other areas of the world, such as the Middle East, have underscored the importance of non-proliferation controls on chemical, biological, and nuclear weapons and missile technology.

The Commerce Department's Bureau of Export Administration (BXA) has responded to the changing world events by focusing much of its attention on items and services that could be used to develop or deliver weapons of mass destruction. Regulations issued pursuant to the President's Enhanced Proliferation Control Initiative (EPCI) were published in 1991 and place greater emphasis on the end-use or end-user of exported items. As a result, exporters need to be more vigilant in screening their customers and transactions.

Before the EPCI regulation changes, license requirements were identified primarily by checking the item and country of destination against the Commerce Control List (CCL). Items not specifically identified on the CCL as controlled to a given destination could, in most instances, be exported under a General License. The export of General License eligible items did not require prior approval from the Department of Commerce except for certain nuclear end-uses and persons denied export privileges.

Under the EPCI controls, a third element, the end-use or end-user, has become critical in determining whether an export requires a license. Under the non-proliferation regulations, items that might not otherwise require a license based upon a review of the CCL and country requirements, could require a license from the Department of Commerce because of the nature of the end-use/user.

The first EMS Guidelines were published in September 1992 to assist companies with the establishment of internal procedures for screening exports. The Guidelines provided steps for exporters to determine whether a license is required because of item/country identification on the CCL. The Guidelines also focused on screening mechanisms that a company could use to determine whether an export required a license because of the nature of the end-use or end-user.

In March 1996, BXA published a complete rewrite of the Export Administration Regulations (EAR) which restructured and reorganized the EAR. While the old EAR had a binary structure, requiring either a "General License" or a "Validated License" for every transaction, the new EAR has a decision tree format. The simplification dropped the term "General License." Items previously exported under the broadest of the old General License, General Destination or G-DEST, may now be exported under "No License Required" (NLR). Those General Licenses that allowed export of items that would otherwise have required a license became "License Exceptions."

The 1997 revised EMS Guidelines incorporate changes necessary to be consistent with the 1996 publication of the Export Administration Regulations.

In response to requests from the business community, BXA has prepared these detailed Export Management System Guidelines to assist firms wishing to establish an internal procedure for screening exports. The information contained in the Guidelines is not meant to modify or interpret the Export Administration Regulations, and no action should be taken based solely on what is contained in the EMS Guidelines.

WHAT IS AN EXPORT MANAGEMENT SYSTEM?

An Export Management System (EMS) is an optional program a company can consider establishing to ensure that their exports and export decisions are consistent with the EAR. An EMS is based on a corporate philosophy that says: "We want to maximize our export sales while ensuring that we comply with the U.S. export laws and regulations." Just as it is vital for a firm to have a system that ensures its tax returns are submitted accurately and on time, an EMS can be an important part of an exporting firm's operation to be sure that it complies with export control requirements. A vital part of an EMS is the establishment of mechanisms within the company that provide checks and safeguards at key steps in the order processing system, helping to better manage the overall export process. Such checks and safeguards help to ensure that the right questions are being asked to preclude exporters from making shipments that are contrary to U.S. export controls and therefore inconsistent with the company's best interests.

HOW CAN AN EMS BE HELPFUL?

An EMS can be a useful tool to help companies comply with export control requirements. The implementation of EPCI and the changing world situation have increased the need for such systems.

The regulations require the exporter to assume greater responsibility in screening export transactions against the prohibitions of exports, reexports, and selected transfers to certain end-users and uses:

- Denied Persons List (General Prohibition Four) - Engaging in actions prohibited by a denial order.

- End-Use/Users (General Prohibition Five) - Export or reexport to prohibited end-uses or end-users.

- Activities of U.S. Persons (General Prohibition Seven) - Activities of U.S. Persons in relation to proliferation activities.

Exporters should also have a procedure in place to screen transactions to ensure that they do not conduct business with persons/firms where BXA has "informed" the exporter or the public at large that the transaction involves an unacceptable risk of use in, or diversion to, prohibited proliferation activities anywhere in the world.

Firms/Persons that act contrary to General Prohibitions could lose their export privileges, be fined, or even be criminally prosecuted.

An EMS is <u>not</u> a U.S. Government mandated requirement. However, in a changing export control environment, it is a program that companies should consider establishing to ensure their actions are handled in a way that is consistent with the EAR.

The establishment of an EMS, in and of itself, will not relieve an exporter of criminal and administrative liability under the law if a violation occurs. However, the implementation of an EMS, coupled with good and sound judgement, can greatly reduce the risk of inadvertently exporting to an unauthorized party or for an unauthorized end-use.

PRELIMINARY STEPS TO CONSIDER IN DEVELOPING AN EMS

There are certain steps that firms will need to address as they begin to develop an EMS.

Know the Customer: A key objective of an effective EMS is to be able to detect and react to information that raises questions about the legitimacy of a customer or transaction. The "Know Your Customer Guidance" help all persons avoid an illegal activity under the EAR. The EAR also prohibits specific activities with "knowledge" that a violation is about to occur. These duties require a certain standard of care. The optional screening suggestions in the Guidelines can help the exporter understand his/her responsibilities.

BXA's "Know Your Customer" Guidance as defined in Supplement 1 to Part 732 of the EAR is included in the booklet as Appendix II. This Guidance refers to the provisions in the regulations that require a license when an exporter "knows" that a proscribed end-use, end-user, destination, activity or other violation is involved. It is important that the exporter have an established procedure for reviewing proposed transactions in accordance with this Guidance. For your convenience, a Checklist of the Red Flag indicators is included with Element 3.

Understanding the EAR: Companies should have a clear understanding of the EAR. Exporters, as well as firms that facilitate exports or engage in other controlled activities, need a working knowledge of the regulations and their applications**.** It is strongly recommended that to develop such an understanding that you send company personnel responsible for Export Controls to one of the many seminars offered by BXA. (For further information, contact the Export Seminar Staff at (202) 482-6031).

Identifying the Factors that will Form the Foundation for the System: Each firm should provide examples, i.e., steps, scope, prohibitions, recordkeeping, etc. of the export regulations that apply to the firm's specific activities. The company's management team should look at a number of factors as it plans the development of its EMS.

A company's EMS should be appropriate to the scope of its export and reexport markets and to its business situation. Several factors can affect how an EMS can be structured. All of the factors noted below are important to consider; however, the most significant are Exporter Size, Location of Customers, Product Sensitivity or Restrictions, and Order Processing System.

A. Exporter Type
- -- Manufacturer
- -- Trading company
- -- Purchasing agent
- -- Original equipment manufacturer (OEM)
- -- Systems integrator

- -- Servicing Agent
- -- Other (i.e., banks, transportation, freight forwarder, etc.)

B. U.S. Person Participation
- -- Direct export
- -- Financing
- -- Shipping
- -- Service
- -- Employment
- -- Other assistance or facilitation

C. Nature of Item Exported
- -- Production material or capital equipment
- -- Part or component
- -- End item:
  - -- for retail consumption
  - -- for use by customer
- -- Software
- -- Technical Data
- -- Service (i.e., financing, freight forwarding, legal, technical, engineering, architectural assistance, etc.)

D. Source of Item Exported
- -- Own manufacture:
  - -- at one location
  - -- at multiple locations
- -- Purchase from manufacturer(s)
- -- Purchase from distributor(s)

E. Item Sensitivity of Restrictions
- -- Authorized for export/reexport to all destinations (except embargoed or terrorist countries)
- -- License Exception eligibility or likelihood of approval under a license to Country Group D (Supp.1 Part 740)
- -- Subject to the missile technology restrictions
- -- Subject to the nuclear restrictions
- -- Subject to the chemical and biological weapons restrictions
- -- Potential for use by restricted nuclear, missile technology, and chemical and biological weapon end-uses/users

F. Exporter Size
- -- Small
- -- Medium

-- Large

G. Customer Type

-- Reseller:
  - -- Distributor
  - -- Sales agent
  - -- Systems integrator
  - -- Original equipment manufacturer (OEM) ie., assembler

-- End-use:
  - -- Government entity
  - -- Manufacturer
  - -- OEM
  - -- Purchaser of capital equipment regardless of nature
  - -- Banks

H. Use of Product by Customer

- -- Capital or other equipment exclusively for own use
- -- Resale to retail customers
- -- Resale to manufacturers or OEMs for own use
- -- Incorporation into new product of manufacture for resale
- -- Support equipment for foreign product for resale
- -- Servicing
- -- Warehousing for further distribution
- -- Systems integration activities
- -- Assembling finished product from kit form
- -- Other

I. Location of Customers

- -- Country Group A **(**see Part 740, Supplement No. 1, to the EAR)
- -- Country Group B
- -- Country Group D:1
- -- Country Group D:2
- -- Country Group D:3
- -- Country Group E

J. Activity of Customers

- -- Disposition in country in which located
- -- Reexports to countries listed in Section I (above)
- -- Exports of foreign manufactured products incorporating U.S. origin parts and components
- -- Exports of foreign manufactured products produced using U.S. origin technical data

K. Exporter/Customer Relationships

-- Customer is a foreign branch of U.S. firm
-- Customer is a foreign subsidiary or affiliate under effective control of U.S. firm
-- U.S. exporter is the subsidiary/branch of customer
-- Independent relationship
-- Firm is a new customer

L. Product Flow

-- Exported from U.S. manufacturing site(s)
-- Exported/reexported from off-shore manufacturing site(s)
-- Direct shipments to an end-customer
-- Shipments direct from a non-affiliated manufacturing entity to a customer

M. Order Processing System

-- Order received at:
    One location
    Several locations
    Regional international sales or headquarters office
-- Records maintained at:
    One central location
    Several locations

The various elements described in the Guidelines, and as noted in the Menu of EMS Elements with specific Objectives identified in Appendix III, constitute compliance options. The elements are not minimum requirements that every exporting firm must follow regardless of its size, products, destinations, and methods of distribution. Rather, the Guidelines provide a "menu" of options a firm may choose from to shape a compliance program uniquely suited to its particular operational features. No one compliance program will be appropriate for every firm. Referring to the factors above can help a firm select elements it believes are appropriate. Some examples may help to illustrate this point.

- A small firm with only two or three employees will probably not need a list with the names, phone numbers, and responsibilities of all persons involved in export control issues. However, such a list may be very useful for large firms.

- Likewise, a small firm will not necessarily develop its own formalized training program. Rather, the firm's employees or owners may familiarize themselves with the EAR and one of the employees will take on export compliance duties in addition to several other duties. In contrast, a large firm might find it extremely valuable to develop its own ongoing training program to educate a large number of employees on evolving export control requirements.

- A firm that exports bacterial agents may develop a compliance program that

includes an extensive screen of end-uses**.** The firm would want to ensure that no exports/reexports of the bacterial agents will be used in any of the prohibited end-uses described in Section 744.4. However, a compliance program for such an exporter need not necessarily include a screen to identify, for instance, nuclear end-uses because their transactions do not involve prohibited nuclear end-uses.

- A firm may have determined that no end-uses/end-users activities described in Part 744 apply to its transactions. Therefore, it does not need to include extensive nuclear, missile or chemical and biological screens. However, it should still set up a procedure for Denied Persons screening and Diversion Risk screening.

- A bank or other financial institution need only be concerned with end-use and end-user screens to avoid prohibited financing or other participation in the design, development, production, stockpiling and use of missiles or chemical/biological weapons and financing certain transactions with Denied Persons.

The size, organizational structure, and production/distribution network of a company will determine the location of activities required to implement and maintain an EMS. In small companies, one individual at one location may perform almost all of the activities. In large or medium-sized companies, these activities may be performed in different organizational areas (comptroller, accounting, sales, marketing, contracts, general counsel, customer service, traffic, corporate audits, order processing, etc.) and/or at different geographical locations (product center, regional office, headquarters, shipping points, etc.).

Some companies choose to designate a single employee responsible for the administration, performance and coordination of these activities (e.g., EMS Administrator). Some large firms decentralize export control responsibilities throughout the organization but with corporate oversight to ensure essential standards are set and maintained.

Regardless of the method of export control coordination or the size of the exporting firm, the person or entity responsible should be sufficiently high in the management hierarchy to maintain and impose a strong commitment to export control activities for the entire firm. In instances where export control activities are decentralized, it is paramount to have knowledgeable staff trained in export control issues at each location or in each function where orders are received and from which/where items are shipped.

Many companies centralize the administration of training, recordkeeping, dissemination of regulatory material, notification of non-compliance, and internal reviews. However, the actual screening activities in some firms of the denied persons lists, end-use and end-user activities, and diversion-risk may be performed by personnel throughout the firm, (e.g., sales and marketing, order entry, or shipping) where firsthand knowledge and information on the consignee is available.

If a firm decides to adopt an EMS, BXA recommends that the export control program be formalized into a written format. This format, an EMS Manual, should describe what elements the firm has identified as necessary to include in its program. Further, it should address "who," "how," "when," and "where," export control checks are conducted.

An exporter clearly benefits from an EMS that:

- protects employees through training and awareness programs from inadvertently violating the EAR.

- protects the firm through on-going control and review systems against inadvertent violations of the EAR.

- demonstrates to the U.S. Government, and a firm's employees, a strong commitment to comply with U.S. export laws and regulations.

- instills confidence that the firm is complying with the letter of the law.

HOW DO I DEVELOP AN EMS?

STEPS DETAILING HOW TO CRAFT AN EMS

Sometimes the toughest part of any job is getting started. This section is intended to offer you with a starting point that has worked for many companies, and is here to give you steps to proceed with the further development of your EMS.

The following five types of facts determine how your EMS should be crafted.

(1) What is it (the item)?
(2) Where is it going (country)?
(3) Who will receive it (end-user)?
(4) What will they do with it (end-use) ?
(5) What else do they do (activity)?

Developing Administrative Elements

The administrative elements are considered to be the foundation of the EMS. These elements may be developed simply by answering questions about your company and the company personnel.

Step One:

Determine which employees are involved in the day to day export functions and identify specific responsibilities of each employee.

Step Two:

Identify the most experienced employee(s) in the area of export controls and appoint an Export Control Administrator.

Step Three:

Evaluate any training programs that you currently have in place and formally detail the type of training that is being done.

Step Four:

Review export control documents (records) and evaluate how they are kept and specifically what is kept.

Step Five:

Refer to the specific elements within the EMS guidelines themselves for a more detailed description of the administrative elements. Formalize your written procedures including the necessary details which apply to your company.

Developing Screening Elements

An ideal place to start in developing the screening elements necessary to perform export control functions, is with the Order Processing Element. This screen will assist firms in combining all of the various screens into a comprehensive flow chart and will allow a firm to demonstrate what screens are addressed during order processing.

Starting with the Order Processing Element is like building the foundation of a puzzle, once the order processing system (foundation) has been established and formalized, it will be easy to fit all of the other pieces in their appropriate place. The following steps should help you place the screening elements into your written procedures/EMS Manual.

Step One:

In narrative form, describe each step of the firm's order entry operation, to the point of shipment.

Step Two:

Create a flow chart that visually displays firm's order processing system narrative (see step one).

Step Three:

On the flow chart, fill in any missing pieces with the screening elements described in the EMS identifying at what point(s) the various screening takes place. Keep in mind that firms should adapt those elements necessary to meet its particular exporting requirements. (Screening elements include the following):

1. Denied Persons Screen/Entities List Screening
2. Product Classification/Licensing Determination Screen
3. Diversion-Risk Screen
4. Nuclear Screen
5. Missile Screen
6. Chemical and Biological Weapons Screen
7. Anti-Boycott Screen (if performed)

Step Four:

Ensure consistent processing of all orders with appropriate “Hold” and “Release” functions.

Step Five:

Once all relevant screening elements have been placed on the flow chart, a more detailed description of those elements may be described and formalized within the individual element of the EMS.

ASSISTANCE IN DEVELOPING AN EMS

Due to the wide diversity of export transactions, firms may still have questions after studying the EAR and reading these guidelines. Again, BXA's Office of Exporter Services (OEXS) seminars may provide assistance in gaining proficiency in the regulations and valuable insights into developing and refining an EMS. Finally, where additional guidance is desired, OEXS's Special License and Compliance Division should be consulted.

For additional guidance, or one-on-one counseling, please telephone or send your EMS program to one of the following offices for review to:

The Office of Exporter Services
Attention: SLCD
P.O. Box 273
Washington, D.C. 20044
(202) 482-4524 or (202) 482-3541 phone
(202) 501-6750 fax

or

Western Regional Office
3300 Irvine Avenue
Suite 345
Newport Beach, CA 92660-3198
(714) 660-0144 phone
(714) 660-9347 fax

or

Northern California Office
101 Park Center Plaza
Suite 1001
San Jose, CA 95113
(408) 998-7402 phone
(408) 998-7470 fax